COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, DECEMBER 23, 2008

APPLICATION OF

VIRGINIA NATURAL GAS, INC.

CASE NO. PUE-2008-00060

For approval to implement a natural gas conservation and ratemaking efficiency plan including a decoupling mechanism and to record accounting entries associated with such mechanism

ORDER APPROVING NATURAL GAS
CONSERVATION AND RATEMAKING EFFICIENCY PLAN

On July 3, 2008, Virginia Natural Gas, Inc. ("VNG" or "Company"), filed with the State Corporation Commission ("Commission") an Application pursuant to the recently enacted Natural Gas Conservation and Ratemaking Efficiency Act ("Act"), § 56-600 *et seq.* of the Code of Virginia ("Code"), seeking approval to implement a natural gas conservation and ratemaking efficiency plan, which includes a decoupling mechanism, and to record accounting entries associated with such mechanism.

As set forth in the Application, the Company's proposed conservation and ratemaking efficiency plan has two principal components: (i) an Energy Conservation Plan ("ECP") to promote conservation and efficiency; and (ii) a Revenue Normalization Adjustment, Rider D ("RNA Rider" or "Rider"), which is a natural gas decoupling mechanism that provides for a sales adjustment to customers' monthly bills. The Application seeks: (1) approval of the ECP and RNA Rider effective January 1, 2009; (2) approval to capitalize the program costs (including capital costs) and to defer such costs pending the appropriate cost of service treatment, including recovery in rates, until the expiration of the Company's performance-based regulation plan

("PBR Plan") period;[1] and (3) authority to begin recording accounting entries associated with the RNA Rider decoupling mechanism effective January 1, 2009.

VNG states in the Application that its proposal does not result in a shift in the annualized allowed distribution revenue between any rate classes and maintains the non-gas revenue per customer within the rate classes established in the Company's PBR Plan. Over the initial three-year term, the Company proposes to spend $7.5 million in these programs (including the cost of capital). For that expenditure, the Company asserts that its customers can save $39.5 million over a 10-year period.[2]

The Company asserts that its proposed decoupling mechanism breaks the link between the volume of sales and the recovery of fixed costs and allows for an increased focus by local distribution companies on energy efficiency and conservation measures. Specifically, the RNA Rider is designed to separate revenues from throughput, enabling VNG to mitigate the impact of declining customer usage and to promote energy efficiency and conservation while recovering its fixed costs. According to VNG, widespread conservation would diminish gas demand and, if significant enough, could dampen natural gas commodity prices. For individual customers, the Application states that any lowering of commodity volumes consumed will result in cost avoidance.

As set forth in the Application, the Company's ECP proposal included the following energy conservation initiatives:

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[1] The Commission approved VNG's PBR Plan in 2006. *See Application of Virginia Natural Gas, Inc., For approval of a performance based rate regulation methodology pursuant to Virginia Code § 56-235.6*, and *General Rate Case Filing of Virginia Natural Gas, Inc., For investigation of justness and reasonableness of current rates, charges, and terms and conditions of service in compliance with prior Commission Order,* Case Nos. PUE-2005-00057 and PUE-2005-00062, 2006 SCC Ann. Rept. 341 (July 24, 2006) ("PBR and Rate Case Order").

[2] *See* Exh. 2 (Gidley direct) at 6.

- *Seasonal Check-Up Program*: $25 customer incentive for check-up or credit toward a programmable thermostat; recommended 21-point inspection and filter examination;

- *Low-Income Home Weatherization Program*: Individual home weatherization at no cost to qualified individuals; $1,650 per home; program to be administered in partnership with current providers of low-income weatherization programs;

- *Energy Efficient Tank Water Heater Program*: $250 incentive; installation of a tank-style natural gas water heater with an energy factor of 0.62 or greater;

- *Tankless Water Heater Program*: $500 incentive; installation of a tankless natural gas water heater with an energy factor of 0.82 or greater;

- *Space Heating Program*: $500 incentive; installation of a 90%+ Efficient Natural Gas Furnace;

- *Pilot ENERGY STAR® Residential New Construction Program*: Natural gas water heater and natural gas furnace incentives plus a $250 incentive to be applied against the cost of the ENERGY STAR® inspections, testing, and modeling; a pilot program to encourage the installation of highly energy efficient ENERGY STAR® rated equipment in residential new construction rather than the standard less-costly and less-efficient equipment;

- *Community Outreach and Customer Education Program*: A broad-based energy conservation education program specifically related to each of the above programs and directed at VNG's customers.[3]

The Company allocates the annual program costs among the above programs and requests "the ability to be flexible and transfer funds from one component to another if it determines that would be more effective or if participation in one of the components is greater than anticipated, ..."[4] The annual program costs also include "$8,000 for the administrative cost related to the processing of the incentive-related payments," and the Company proposes "to

[3] Exh. 5 (France direct), Attach. CJF-1.

[4] Exh. 6 (Hickerson direct) at 6.

defer the cost related to the annual independent verification of the net benefits . . . as required by the new legislation, and other incremental ECP costs[, which] are not expected to exceed $25,000."[5] Finally, the Application requests authority to capitalize the program costs (including capital costs) and to defer such costs pending the appropriate cost of service treatment, including recovery in rates, until the expiration of VNG's PBR Plan period on August 1, 2011, during which time the Company's base rates are frozen pursuant to the Commission's decision in Case Nos. PUE-2005-00057 and PUE-2005-00062.

On July 14, 2008, the Commission issued an Order for Notice and Hearing that, among other things, directed the Company to provide notice of its Application, established a procedural schedule for this case, and scheduled a public hearing to receive testimony from members of the public and evidence on the Application. The Commission subsequently extended the procedural schedule in response to a motion filed by the Office of the Attorney General's Division of Consumer Counsel ("Consumer Counsel"). The Commission received written comments from: the New Kent County Board of Supervisors (opposing a rate increase); the Natural Resources Defense Council ("NRDC") (supporting efforts to implement decoupling and energy efficiency programs); and the Virginia Interfaith Center for Public Policy ("Center") (supporting the Application).

On October 14, 2008, the Commission convened a public hearing for the purpose of receiving testimony from public witnesses, and the following testified as public witnesses thereat: Brandi Colander on behalf of NRDC; and Rev. C. Douglas Smith on behalf of the Center.

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[5] *Id.*

On October 22, 2008, VNG filed a Proposed Stipulation and Recommendation between VNG and Consumer Counsel.

On October 23, 2008, the Commission convened a public evidentiary at which the following participated and presented one or more witnesses: VNG; Consumer Counsel; and the Commission's Staff ("Staff").

On October 29, 2008, VNG filed a Proposed Stipulation and Recommendation (REVISED) ("Revised Stipulation") between VNG and Consumer Counsel, as had been discussed during the October 23 hearing. The Revised Stipulation includes the following modifications to the Company's proposed conservation and ratemaking efficiency plan:

1. The VNG Community Outreach and Customer Education Program will include, through VNG bill inserts and/or other media materials, energy efficiency and conservation educational information targeted to all VNG residential customers throughout each year of the [ECP]. The Company will also make available to every VNG residential customer a $4.00 coupon each year for replacement of an air filter through a supplier with whom VNG will partner (*e.g.*, Home Depot, Sears, *etc.*), with the expectation of attaining high customer participation. The total cost of all (ECP) programs will not change. Program costs for the air filter coupon will be included as part of the Community Outreach and Customer Education spending.

2. An Energy Conservation and Efficiency Advisory Group will be formed (the composition of which will be mutually agreed upon by VNG, the Commission and Consumer Counsel), which will meet periodically to evaluate, review, and recommend adjustments to VNG's conservation and energy efficiency programs (*i.e.*, ECP), including items such as, but not limited to: evaluating results, customer behavior and additional needs of the customers; reviewing program participation, public perception, attendance at outreach meetings, and participation on the Company's website; and recommending new conservation and efficiency technology and hotline telephone numbers to provide conservation advice, new and revised conservation education programs, forums, potential partnerships that should be explored for increased outreach, and change in media/messaging based on review of results.

3. The Company will also implement a programmable thermostat program in which the Company will partner with a supplier to make thermostats available to a group of customers at wholesale prices by taking advantage of bulk purchasing. The Company will provide $25 per customer towards the purchase of these thermostats. The Company will spend $125,000 on this program. The total cost of all (ECP) programs will not change. Program costs will be reallocated as shown on Exhibit A [to the Revised Stipulation]. In addition, as described in the seasonal check up program included in VNG's Application, customers would still be eligible to receive $25 toward the purchase of a programmable thermostat if they choose to purchase a model other than what the Company provides under the program described in this paragraph of the Stipulation.

4. In compliance with the Va. Code § 56-602, VNG will, on an annual basis, file an annual report with Commission Staff showing the year-over-year weather-normalized use of natural gas on an average customer basis for the Residential Customer Class and an independently-verified report of the economic benefits created by the conservation and energy efficiency programs (*i.e.*, ECP). Such report will include the findings and recommendations of the Energy Conservation and Efficiency Advisory Group, including cost benefit analysis of the conservation and energy efficiency programs (*i.e.*, ECP), participation rates, an effectiveness test comparing results to a non-participating control group, and expected program benefits for the next program year.

5. The [plan] shall be limited to an initial period of not more than 3 years from the effective date approved by the Commission. If VNG desires to continue the [plan] after the 3-year period, it will be required to seek further authority to do so from the Commission.

6. Nothing herein shall prevent the Energy Conservation and Efficiency Advisory Group from proposing mutually agreeable changes to the ECP within the 3-year period.

7. The Company shall not earn a return or recover any form of carrying costs on deferred incremental costs incurred within the 3-year period for its conservation and energy efficiency programs. The undersigned parties agree that the Company's proposal as modified herein complies with the definition "Cost-effective conservation and energy efficiency program" for purposes of recovery of deferred incremental costs pursuant to Va. Code

> § 56-602.D. The ECP costs, excluding carrying costs, shall be included in VNG's next rate proceeding as an expense for recovery over an amortized period. The deferred ECP costs will not be classified as rate base in VNG's next rate proceeding.[6]

On November 26, 2008, VNG, Consumer Counsel, and Staff filed post-hearing briefs.

NOW THE COMMISSION, having considered this matter, is of the opinion and finds that a conservation ratemaking and efficiency plan as permitted by § 56-600 *et seq.* of the Code is approved as set forth in this Final Order. We approve the Revised Stipulation entered into by VNG and Consumer Counsel and, consistent with the Revised Stipulation, we (1) direct a reallocation of the program costs among the ECP programs to ensure compliance with the Act, and (2) do not increase the *total* cost to the Company of all ECP programs.

This is the first case under the Act. We find that the conservation ratemaking and efficiency plan, as defined by the provisions of the Revised Stipulation and the requirements of this Final Order ("Plan"), satisfies the statutory requirements of the Act.

Code of Virginia

Section 56-602 A of the Code provides in part as follows:

> Notwithstanding any provision of law to the contrary, each natural gas utility shall have the option to file a conservation and ratemaking efficiency plan as provided in this chapter. Such a plan may include one or more residential, small commercial, or small general service classes, but shall not apply to large commercial or large industrial classes of customers. Such plan shall include: (i) a normalization component that removes the effect of weather from the determination of conservation and energy efficiency results; (ii) a decoupling mechanism; (iii) one or more cost-effective conservation and energy efficiency programs; (iv) provisions to address the needs of low-income or low-usage residential customers; and (v) provisions to ensure that the rates and service to non-participating classes of customers are not adversely impacted. Such plan may also include provisions for phased or targeted

[6] Exh. 3 (Revised Stipulation) at 1-4.

> implementation of rate or tariff design changes, if any, or conservation and energy efficiency programs.

Section 56-602 B of the Code directs in part as follows:

> The Commission shall approve or deny, within 180 days, a natural gas utility's initial application for any revenue-neutral conservation and ratemaking efficiency plan that allocates annual per-customer fixed costs on an intra-class basis in reliance upon a revenue study or class cost of service study supporting the rates in effect at the time the plan is filed. A plan filed pursuant to this subsection shall not require the filing of rate case schedules. . . . The Commission shall approve such a plan . . . if it finds that the plan's . . . proposed decoupling mechanism is revenue-neutral and is otherwise consistent with this chapter.

Section 56-600 of the Code includes definitions of some of the terms used above, including the following:

> '*Allowed distribution revenue*' means the average annual, weather-normalized, nongas commodity revenue per customer associated with the rates in effect as adopted in the applicable utility's last Commission-approved rate case or performance-based regulation plan, multiplied by the average number of customers served.
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> '*Conservation and ratemaking efficiency plan*' means a plan filed by a natural gas utility pursuant to this chapter that includes a decoupling mechanism.
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> '*Cost-effective conservation and energy efficiency program*' means a program approved by the Commission that is designed to decrease the average customer's annual, weather-normalized consumption or total gas bill, for gas and nongas elements combined, or avoid energy costs or consumption the customer may otherwise have incurred, and is determined by the Commission to be cost-effective after analyzing such program using the Total Resource Cost Test, the Societal Test, the Program Administrator Test, the Participant Test, the Rate Impact Measure Test, and any other test the Commission reasonably deems appropriate. The Commission may determine the weight to be given to a test. Without limitation, rate designs or rate mechanisms, customer education, customer incentives, and weatherization programs are examples of conservation and energy efficiency programs that the Commission may consider.

> '*Decoupling mechanism*' means a rate, tariff design or mechanism that decouples the recovery of a utility's allowed distribution revenue from the level of consumption of natural gas by its customers, including (i) a mechanism that adjusts actual nongas distribution revenues per customer to allowed distribution revenues per customer, such as a sales adjustment clause, (ii) rate design changes that substantially align the percentage of fixed charge revenue recovery with the percentage of the utility's fixed costs, such as straight fixed variable rates, provided such mechanism includes a substantial demand component based on a customer's peak usage, or (iii) a combination of clauses (i) and (ii) that substantially decreases the relative amount of nongas distribution revenue affected by changes in per customer consumption of gas. . . .
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> '*Revenue-neutral*' means a change in a rate, tariff design or mechanism as a component of a conservation and ratemaking efficiency plan that does not shift annualized allowed distribution revenue between customer classes, and does not increase or decrease the utility's average, weather-normalized nongas utility revenue per customer for any given rate class by more than 0.25 percent when compared to (i) the rate, tariff design or mechanism in effect at the time a conservation and ratemaking efficiency plan is filed pursuant to this chapter or (ii) the allocation of costs approved by the Commission in a rate case using the cost of service methodology set forth in § 56-235.2 or a performance-based regulation plan authorized by § 56-235.6, where a plan is filed in conjunction with such case.

Section 56-602 E of the Code mandates as follows:

> The Commission shall require every natural gas utility operating under a conservation and ratemaking efficiency plan approved pursuant to this chapter to file annual reports showing the year over year weather-normalized use of natural gas on an average customer basis, by customer class, as well as the incremental, independently verified net economic benefits created by the utility's cost-effective conservation and energy-efficiency programs during the previous year.

Conservation and Ratemaking Efficiency Plan

Both parts of the Plan - *i.e.*, the ECP and the RNA Rider - apply only to VNG's residential customers served under Rate Schedule 1 (Residential Firm Gas Sales Service) and

Rate Schedule 3 (Residential Air Conditioning Firm Gas Sales Service).[7] Accordingly, the Plan complies with the requirement in § 56-602 A of the Code that "[s]uch a plan may include one or more residential, small commercial, or small general service classes, but shall not apply to large commercial or large industrial classes of customers."

Conservation and energy efficiency programs

As noted above, the first principal component of the Plan is the ECP, which contains the Company's proposed conservation and energy efficiency programs.

Normalization component

As required by § 56-602 A (i) of the Code, the Plan includes "a normalization component that removes the effect of weather from the determination of conservation and energy efficiency results." VNG explains as follows:

> The Company will . . . compute the weatherized usage and revenue that will be used in the determination of the conservation and energy efficiency results. In addition, we will track, on an individual premise basis, the consumption and revenue for each premise that participates in any component of the ECP (the Company's initiatives to encourage conservation and efficiency). The usage and revenue associated with each of these premises will be weather normalized to allow for the effectiveness of the respective plans to be evaluated on a component-by-component basis.[8]

Low-income or low-usage residential customers

As required by § 56-602 A (iv) of the Code, the Plan includes "provisions to address the needs of low-income or low-usage residential customers." The Plan, as proposed and approved herein, includes a Low-Income Home Weatherization Program that, among other things: (1) will be administered in partnership with current providers of low-income weatherization programs;

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[7] *See, e.g.,* Exh. 6 (Hickerson direct), Attach. ARH-1 at 1.

[8] Exh. 6 (Hickerson direct) at 14-15.

(2) will provide individual home weatherization at no cost to qualified individuals at a value of up to $1,646 per home; (3) will have a total program cost of $372,075; and (4) will serve at least 226 low-income households.[9]

Cost-effective conservation and energy efficiency programs

Section 56-602 A (iii) of the Code states that the Plan "shall include . . . one or more *cost-effective* conservation and energy efficiency programs" (emphasis added). As noted above, the Act includes a definition for a "cost-effective conservation and energy efficiency program."[10] That definition, among other things, requires the Commission to determine whether such program is cost-effective after analyzing the program using several named tests "and any other test the Commission reasonably deems appropriate."[11] In addition, the Act does not require that a program pass any or all of the tests and, further, provides that "[t]he Commission may determine the weight to be given to a test."[12]

In this regard, the ECP passes all the named tests except the Rate Impact Measure Test ("RIM Test").[13] The RIM Test generally measures the rate impact on residential customers that do not participate in the ECP and, thus, is sometimes referred to as the "Non-Participant Test."[14] Staff explained that, under VNG's own analysis included in its Application, approximately 96% of residential customers will be *negatively* impacted by the ECP in any given year - *i.e.*, 96%

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[9] *See, e.g.,* Exh. 5 (France direct) at 8-9; Exh. 20 (France rebuttal) at 4-5; Exh. 3 (Revised Stipulation), Exhibit A.

[10] Va. Code § 56-600.

[11] *Id.*

[12] *Id.*

[13] *See, e.g.,* VNG's November 26, 2008 post-hearing brief at 35-37; Staff's November 26, 2008 post-hearing brief at 6-8, 14-15; Consumer Counsel's November 26, 2008 post-hearing brief at 3-5.

[14] *See, e.g.,* Exh. 8 (Watkins direct) at 5-6; Exh. 14 (Walker direct) at 8.

could pay higher bills than they otherwise would have absent the ECP.[15] Indeed, Consumer Counsel explains that the ECP requires "non-participating [residential] ratepayers to pay for the monetary benefits received only by the program's participants. . . ."[16]

This disparity, however, highlights one of the ratemaking premises reflected in the Act: customers in a rate class who do not conserve (*i.e.*, assumed non-participants) may pay more in order for the Company to recoup the revenue lost from those who conserved. This policy, built into the statute, will necessarily make it difficult for many conservation programs to meet the RIM Test. Consumer Counsel explains this by noting that, under the Act, there will be "disparate impact" between participants and non-participants in a rate class, and that the Commission should determine whether such impact "is reasonable or not."[17] Thus, Consumer Counsel "*cautions* the Commission against applying the RIM Test in a manner that could result in adopting a policy that *no* conservation and energy efficiency programs as envisioned by the Act would *ever* be approved."[18]

The Act also permits the Commission to analyze the ECP using "any other test the Commission reasonably deems appropriate."[19] The results of the RIM Test highlight the limited number of residential customers that are expected to take part in the ECP as proposed in the

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[15] *See* Exh. 14 (Walker direct) at 9.

[16] Exh. 8 (Watkins direct) at 7.

[17] Consumer Counsel's November 26, 2008 post-hearing brief at 6.

[18] *Id.* (emphasis added). Although passage of the RIM Test is not a statutory prerequisite for approval, VNG (1) agrees that the Commission should not ignore the rate impact on non-participants, which VNG estimates at less than $0.72 per month, and (2) notes that the Act specifically permits "targeted" implementation of such programs. VNG's November 26, 2008 post-hearing brief at 35-36.

[19] Va. Code § 56-600.

Application. Thus, we find that it is reasonably appropriate to consider the number of customers targeted, and the type of programs that they are targeted with, as part of the ECP.[20] In this regard, we conclude as follows: (1) that for the Plan to be cost effective under the Act, the annual funds proposed by the Company should be allocated in a manner that appreciably increases the realistically possible number of participants in significant conservation measures; and (2) that this shall be accomplished by increasing the allocation of funds for the Programmable Thermostat Program resulting in a total allocation as set forth below. This reallocation of funds should, among other things, help to reduce the potential number of non-participants that will be required to pay for this Plan, but that gain no benefit thereunder.

Accordingly, the ECP shall reflect the following allocation:

Community Outreach and Customer Education Program
Annual Cost: $750,000
Incentive: --
Number of Participants: --

Programmable Thermostat Program
Annual Cost: $625,000
Incentive: $25
Number of Participants: 25,000

Low-Income Home Weatherization Program
Annual Cost: $372,075
Incentive: $1,646
Number of Participants: 226

Seasonal Check-Up Program
Annual Cost: $188,750
Incentive: $25
Number of Participants: 7,550

[20] We recognize that the Revised Stipulation, which includes a $4.00 air filter coupon (to be paid out of the funds allocated to the Community Outreach and Customer Education Program) and a Programmable Thermostat Program for 5,000 customers, should increase participation in the ECP. *See* Exh. 3 (Revised Stipulation).

Tank Water Heater Program
Annual Cost: $26,500
Incentive: $150
Number of Participants: 177

Tankless Water Heater Program
Annual Cost: $98,000
Incentive: $500
Number of Participants: 196

Space Heating Program
Annual Cost: $98,000
Incentive: $500
Number of Participants: 196

ENERGY STAR® Residential New Construction Program
Annual Cost: $5,000
Incentive: $250
Number of Participants: 20

This reallocation does not exceed the *total* cost of the ECP programs contained in the Revised Stipulation and is consistent with the Revised Stipulation. We find that, at this time, the above allocation is necessary to make the ECP "cost-effective" under the Act and to address the potential deficiencies in the Plan identified by the RIM Test. We recognize, as did VNG, that it may be reasonable to transfer funds from one program to another after gaining actual experience with the ECP, without increasing the total cost of all programs.[21] Furthermore, the Revised Stipulation provides that the Energy Conservation and Efficiency Advisory Group (created as part of the Revised Stipulation) will evaluate and recommend changes to the ECP programs during the three-year term of the Plan. Accordingly, while we direct the cost allocations set forth above at this time, we do not preclude modifications thereto after the first year of the Plan. Thus, in accordance with the Revised Stipulation, the reallocation directed herein may be reviewed by the Energy Conservation and Efficiency Advisory Group, and requests for any further

[21] *See* Exh. 6 (Hickerson direct) at 6.

reallocations of ECP program costs during the life of the Plan may be made to this Commission by that group.

Decoupling mechanism

As noted above, the second principal component of the Plan is the RNA Rider, which represents the Company's proposed decoupling mechanism under § 56-602 A (ii) of the Code. We find that the RNA Rider, which is a sales adjustment clause, complies with the specific provisions of the Act and, as required by § 56-602 B of the Code, is otherwise consistent with the provisions of the Act.

Sales adjustment clause

Staff opposed the form of the Rider, preferring that such a Rider, if any, be in the form of a change in rate design and not a sales adjustment clause.[22] This position, however, is contrary to the explicit language of the statute permitting the decoupling mechanism to take the form of a sales adjustment clause. Specifically, as permitted by the Act, the Rider is a "mechanism that decouples the recovery of a utility's allowed distribution revenue from the level of consumption of natural gas by its customers, including (i) a mechanism that adjusts actual nongas distribution revenues per customer to allowed distribution revenues per customer, such as a *sales adjustment clause*."[23]

Customer classes

As required by § 56-602 A (v) of the Code, the Plan includes "provisions to ensure that the rates and service to non-participating classes of customers are not adversely impacted." The Act describes "classes of customers" in terms of "residential, small commercial, . . . small

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[22] *See, e.g.*, Tr. 233-234.

[23] Va. Code § 56-600 (emphasis added).

general service classes, [and] large commercial or large industrial classes of customers."[24] The Plan only applies to the residential class of customers, and the rates and service to "non-participating classes of customers" - *i.e.*, small commercial, small general service, large commercial, and large industrial classes - are not impacted, adversely or otherwise, by the Plan.[25]

In this regard, we reject Staff's proposition that customer classes - under the express terms of the Act - could mean something other than the residential, small commercial, small general service, large commercial, and large industrial customer classes.[26] Rather, we agree with Consumer Counsel's explanation as follows:

> The statute speaks in terms of the residential, small commercial, small general service, large commercial, and large industrial classes of customers. The entire residential class of customers - Schedules 1 and 3 - is included under VNG's proposed [Plan]. The small commercial and small general service classes are legally eligible to be included in a [Plan], but under VNG's proposed plan those classes are not included. Thus, in this instance, Consumer Counsel understands subdivision (v) to require that rates and service under VNG's [Plan] applicable to the residential class of customers not adversely impact the small commercial or small general service classes of customers, as well as the large commercial and large industrial classes of customers.[27]

Thus, contrary to Staff's suggestion, which diverges from the plain language of the Act, the Act does not permit the Commission to create subsets of classes within the residential class as identified by statute.

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[24] Va. Code § 56-602 A.

[25] *See, e.g.*, Exh. 6 (Hickerson direct) at 18.

[26] *See, e.g.*, Tr. 275-279.

[27] Consumer Counsel's November 26, 2008 post-hearing brief at 7.

Revenue-neutral

Similarly, as required by the Act's definition of "revenue-neutral," the RNA Rider "does not shift annualized allowed distribution revenue between *customer classes*."[28] No revenue is shifted between customer classes; the ECP and the Rider only apply to the residential class of customers.

Next, as also required by the Act's definition of "revenue-neutral," the RNA Rider "does not increase or decrease the utility's average, weather-normalized nongas utility revenue per customer for any given rate class by more than 0.25 percent when compared to (i) the rate, tariff design or mechanism in effect at the time a conservation and ratemaking efficiency plan is filed pursuant to this chapter."[29] As noted by VNG, the "rates in effect at the time VNG filed its Plan were adopted by the Commission in the Company's PBR Plan Proceeding."[30] Under the PBR Plan, VNG's average, weather-normalized nongas utility revenue per customer for the residential class is $223.68, and the RNA Rider is designed to ensure that such revenue per customer remains at $223.68.[31]

Staff asserts, nonetheless, that the Rider is not revenue-neutral. The RNA Rider, as required by the Act, is based on the PBR Plan that, in turn, is based on usage for the 12 months ending March 2005.[32] Staff explains that usage during that 12-month period was higher than any

[28] Va. Code § 56-600 (emphasis added).

[29] Va. Code § 56-600. Contrary to Staff' suggestion, subsection (ii) of the definition of "revenue-neutral" in § 56-600 of the Code is inapplicable herein, because the Plan was not "filed in conjunction with" a rate case or PBR plan.

[30] VNG's November 26, 2008 post-hearing brief at 9.

[31] *See, e.g.,* Exh. 16 (Hickerson rebuttal) at 3-4; VNG's November 26, 2008 post-hearing brief at 11-12.

[32] *See, e.g.,* Exh. 14 (Walker direct) at 15.

subsequent 12-month period.[33] For example, Staff illustrates that if the RNA Rider was in effect during 2006 and 2007 - without the ECP program - VNG's revenues would have increased by over 5%; that is, customers would have paid over 5% more than they actually paid during 2006 and 2007 if the RNA Rider was in effect.[34] We must reject Staff's conclusion as a matter of law. The Act explicitly defines "revenue-neutral" as applied above, and Staff's analysis does not comply with such definition.

<u>Efficiency targets and penalties for poor performance</u>

VNG states that the Natural Resources Defense Council ("NRDC") "has filed comments in this proceeding supporting the Company's decoupling and conservation plan. . . ."[35] The NRDC, however, testified at the hearing that it is not familiar with the specific conservation programs proposed by VNG in its Application.[36] The NRDC also asserts that in conjunction with the benefits received by the Company through the decoupling mechanism, the Plan also should include energy "efficiency targets" for VNG and should reflect "penalties for poor performance" by VNG under the ECP.[37] Staff similarly suggests that the decoupling mechanism be linked to the amount of conservation achieved under the ECP.[38] The Company, however, asserts that "[d]ecoupling revenue should not be directly tied to conservation,"[39] and

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[33] *Id.*

[34] *See* Exh. 14 (Walker direct) at 15-16.

[35] VNG's November 26, 2008 post-hearing brief at 41.

[36] Tr. 13-14.

[37] *See, e.g.*, Tr. 10-12; NRDC's October 8, 2008 comments at 3.

[38] *See, e.g.*, Exh. 12 (Spinner direct) at 20-21; Exh. 14 (Walker direct) at 20-21.

[39] *See* VNG's November 26, 2008 post-hearing brief at 21 (typeface modified).

"[decoupling revenue to VNG] is not a reward for conservation. . . ."[40] In this regard, the Company is correct that the Act does not require the linkage recommended by the NRDC and Staff. Although the NRDC asserts that such efficiency targets and penalties for poor performance should be part of any successful decoupling program, the Act includes no provision for such penalties and does not tie the definition of "decoupling mechanism" to any amount of conservation. Accordingly, we must deny the NRDC's and Staff's recommendations in this regard.

<u>Bills</u>

Staff states that: (1) the RNA Rider represents VNG's "third adjustment to the bills of its residential customers;" (2) the two current adjustments are to reflect (a) normal weather (*i.e.*, a weather normalization adjustment ("WNA")), and (b) purchased gas costs; and (3) the "layering of rate adjustments can give rise to billing errors and increased customer confusion."[41]

In this regard, we note that the RNA Rider adjustment (i) is a monthly adjustment, and (ii) can represent either a credit or a surcharge to the customer's bill. Similarly, the WNA (i) is a monthly adjustment, and (ii) can represent either a credit or a surcharge to the customer's bill. Further, the Commission requires VNG to list the impact of the WNA as a separate line item on the customer's monthly bill; this provides a reasonable level of billing transparency and assists in identifying the individual bill impact of the WNA program. We likewise find that VNG shall list the impact of the RNA Rider adjustment as a separate line item on the customer's monthly bill. As with the WNA, we find that the risk of confusion from a separate line item is outweighed by the value to customers of billing transparency.

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[40] *Id.* at 22.

[41] Exh. 14 (Walker direct) at 26.

Reports

As required by § 56-602 E of the Code, VNG will file annual reports "'showing the year over year weather-normalized use of natural gas on an average customer basis, by customer class, as well as the incremental, independently verified net economic benefits created by the utility's cost-effective conservation and energy-efficiency programs during the previous year.'"[42] We further note that the Plan, as approved herein, includes the following provision:

> In compliance with the Va. Code § 56-602, VNG will, on an annual basis, file an annual report with Commission Staff showing the year-over-year weather-normalized use of natural gas on an average customer basis for the Residential Customer Class and an independently-verified report of the economic benefits created by the conservation and energy efficiency programs (*i.e.*, ECP). Such report will include the findings and recommendations of the Energy Conservation and Efficiency Advisory Group, including cost benefit analysis of the conservation and energy efficiency programs (*i.e.*, ECP), participation rates, an effectiveness test comparing results to a non-participating control group, and expected program benefits for the next program year.[43]

PBR Plan

Consumer Counsel and Staff note the potential conflict between the Plan and VNG's existing PBR Plan as approved by the Commission.[44] The Company, however, correctly points out that the Act explicitly permits VNG to implement a conservation and ratemaking efficiency plan regardless of whether the Company is operating under a Commission-approved PBR Plan.[45] Section 56-601 B of the Code provides as follows: "Natural gas utilities are authorized pursuant to this chapter to file natural gas conservation and ratemaking efficiency plans that implement

[42] *See, e.g.*, VNG's November 26, 2008 post-hearing brief at 39-40.

[43] Exh. 3 (Revised Stipulation) at 3-4.

[44] *See, e.g.*, Exh. 8 (Watkins direct) at 15-16; Exh. 14 (Walker direct) at 16.

[45] *See* VNG's November 26, 2008 post-hearing brief at 8-9.

alternative natural gas utility rate designs and other mechanisms, in addition to . . . performance-based regulation plans authorized by § 56-235.6." Moreover, as noted above, § 56-602 A of the Act further states as follows: "Notwithstanding any provision of law to the contrary, each natural gas utility shall have the option to file a conservation and ratemaking efficiency plan as provided in this chapter." Accordingly, we find that VNG's existing PBR Plan does not stand as a legal impediment to implementation of the Plan herein.

At the same time, we must also acknowledge that the Plan will necessarily change the amount that VNG's customers otherwise would have paid for non-gas service under the PBR Plan as approved by the Commission.[46] In the PBR and Rate Case Order, the Commission found that VNG's annual revenues needed to be *reduced* by approximately $9.83 million in order for rates to be considered "just and reasonable."[47] The Commission, however, did not order a rate decrease but, rather, approved the existing PBR Plan that, among other things: (1) requires VNG to construct a pipeline from its northern system that will cross the James River/Hampton Roads Channel and tie into VNG's distribution system in Norfolk to allow for the physical flow of gas

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[46] For example, while the Commission does not currently intend to re-open the PBR Plan for further evaluation, we recognize that the PBR statute directs that the Commission may "alter, amend or revoke" a previously approved PBR Plan if it finds, among other things, that:

> (iv) the performance-based form of regulation is resulting in rates that are excessive compared to a gas utility's or electric utility's cost of service and any benefits that accrue from the performance-based plan; (v) the terms ordered by the Commission in connection with approval of a gas utility's or electric utility's implementation of a performance-based form of regulation have been violated; or (vi) the performance-based form of regulation is no longer in the public interest.

Va. Code § 56-235.6 C.

[47] *See* PBR and Rate Case Order, 2006 SCC Ann. Rept. at 347.

from the northern system to the southern system ("HRX Pipeline"); and (2) freezes VNG's non-gas rates for five years (August 1, 2006, to July 31, 2011).[48]

The Commission approved the rates in the PBR Plan[49] because we found that those rates complied with the specific requirements of the PBR statute; to wit, we found that the PBR Plan did "not result in excessive rates" under § 56-235.6 B of the Code "when compared to the benefits" to customers under the PBR Plan, which included the Company's commitment to construct the HRX Pipeline (a commitment that VNG has kept)[50] and the projected long-term cost savings to customers over the life of the HRX Pipeline.[51] Thus, having found that VNG's annual non-gas revenues should be reduced by $9.83 million, allowing non-gas rates to remain unchanged through the five-year PBR Plan period was a necessary and obviously critical component of our approval of that plan.

Indeed, in seeking approval of the PBR Plan, the Company repeatedly assured the Commission that VNG's customers would be assured of "rate certainty" for the non-gas portion of service for the five-year life of the PBR Plan.[52] The Commission relied upon such representations in approving the PBR Plan and, further, explained that rates would be reduced by

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[48] *Id.*

[49] Commissioner Jagdmann did not participate in the PBR and Rate Case Order.

[50] *See, e.g.,* VNG's November 12, 2008 Report of Action in Case No. PUE-2005-00057.

[51] *See* PBR and Rate Case Order, 2006 SCC Ann. Rept. at 349.

[52] *See, e.g.,* the following statements from VNG in Case No. PUE-2005-00057: "The PBR Plan freezes VNG's [non-gas] rates at their 1996 level until 2011. This provides continued stable rates [over the five-year PBR period] - a guarantee of 14 years of stable base rates . . ." (Application at 9); "[The five-year rate freeze] provide[s] *rate certainty* for our customers for at least five years" (January 27, 2006 Statement of VNG President Henry P. Lingenfelter at 6 (emphasis added)); "[A]ll parties to the [PBR] case have agreed to the current rates for a five-year period" (VNG's January 30, 2006 Reply at 6); and "[The five-year rate freeze] provid[es] *rate certainty* to all VNG customers for at least five years" (VNG's January 30, 2006 Reply at 4 (emphasis added)).

$9.83 million if the PBR Plan was ever withdrawn or terminated.[53] That reliance, however, apparently was misplaced since, upon implementation of the Plan, the price paid by many - if not all - residential customers for non-gas service may likely increase.

First, as discussed above, the Plan is structured so that the Company is guaranteed to recover the average, weather-normalized non-gas utility revenue per customer that is reflected in the PBR Plan. While we conclude that the RNA Rider is "revenue-neutral" as that term is defined by the Act, the Rider is by no means "revenue-neutral" in terms of its likely actual effect on individual customers. The Plan is structured so that VNG is guaranteed to recover a certain amount of revenue from the residential class, regardless of how much natural gas the class uses as a whole. This is accomplished, through the Rider, by effectively increasing rates to all members of the residential class, via a "sales adjustment" when sales volumes decline, in order to meet VNG's guaranteed revenue for that class.[54] As a result, all customers - whether or not they decrease their individual natural gas usage - end up paying more to VNG for the non-gas portion of their bills.

The Company acknowledges that, under its Plan, the bill increases to individual customers are not directly tied to any particular conservation targets or savings, such as, *e.g.*, when VNG states that "decoupling revenue [to VNG] should not be directly tied to conservation"[55] savings to customers, and "[decoupling revenue to VNG] is not a reward for

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[53] *See* PBR and Rate Case Order, 2006 SCC Ann. Rept. at 349 ("If the PBR Plan is withdrawn or terminated, and absent a subsequent rate case or performance based ratemaking methodology, VNG's rates shall be established in accordance with the revenue requirements and rate design found just and reasonable by the Commission under § 56-235.2 A of the Code in Case No. PUE-2005-00062.").

[54] Conversely, VNG asserts that customers would receive a credit under the RNA Rider if the revenue per customer exceeds that reflected in the PBR Plan. *See* Exh. 16 (Hickerson rebuttal) at 12.

[55] VNG's November 26, 2008 post-hearing brief at 21.

conservation . . . ."[56] Moreover, when VNG states that the Act "allows cost shifting on an intra-class basis,"[57] it recognizes that individual VNG residential ratepayers may pay more than they are currently paying under the PBR Plan rate structure, even if they reduce their consumption of natural gas or already use relatively little gas.

Second, and as also explained above, the RNA Rider is based on the usage and revenue reflected by the PBR Plan. This PBR Plan revenue is based on historical customer usage for the 12 months ending March 2005, and Staff explains that "there has been no single consecutive 12-month period when actual usage conditions were higher than the [RNA Rider] targets since March 2005."[58] For example, in 2006 and 2007 the average usage was less than that for the 12 months ending March 2005. As a result, if the RNA Rider was in effect during 2006 and 2007, residential customers would have seen a "sales adjustment" under the Rider in order to increase VNG's revenues. In other words, if the RNA Rider was in effect during 2006 and 2007, residential customers' bills would have been *higher* than they actually were in 2006 and 2007 under the PBR Plan - and this is without any ECP programs.[59] Thus, the implementation of the RNA Rider clearly may increase residential customers' bills from what they otherwise would have been under the PBR Plan.

VNG asserts, however, that this result from the Rider is not technically a *rate increase* but, rather, represents a *sales adjustment* as permitted by the Act. VNG claims that a "sales adjustment clause" - such as the RNA Rider - which increases a customer's bill pursuant to the Act is not the same thing as a rate increase because the "sales adjustment clause allows [VNG] to

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[56] *Id.* at 22.

[57] *Id.*

[58] Exh. 14 (Walker direct) at 15.

[59] *See, e.g.,* Exh. 14 (Walker direct) at 15; Exh. 8 (Watkins direct) at 17-19.

obtain its 'allowed distribution revenue' without changing its rates."[60] While we find that VNG is technically correct in its legal interpretation of a "sales adjustment clause" under the Act, we also recognize that this technical ratemaking distinction is likely of little comfort to ratepayers. If a customer's bill goes up, calling it a *sales adjustment* – as opposed to a *rate increase* – does not change the fact that the customer's bill is higher than it otherwise would have been.[61] As a result, we must acknowledge that while customers' "rates" technically may not change as a matter of legal analysis under the Act, the actual effect of VNG's sales adjustment clause (*i.e.*, the RNA Rider) may be increases in many customers' bills versus what they would have been under the PBR Plan, which we approved in 2006 with the expectation that we were ensuring "rate certainty" as represented by VNG.

Accordingly, while we approve the Plan herein pursuant to the Act, we must acknowledge that the ultimate price that VNG's residential customers will pay for non-gas service under the Plan may be higher than the frozen rates established by the Commission in the PBR Plan. This is especially relevant at a time of economic hardship when many of VNG's customers are struggling to pay their monthly bills and may be facing tremendous uncertainty about their employment security.[62]

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[60] VNG's November 26, 2008 post-hearing brief at 17 (quoting Va. Code § 56-600). *See also id.* at 9-13.

[61] In other words, it is possible that a particular customer's bill could be higher for an equivalent amount of natural gas consumed. This higher cost per unit of consumption would typically be considered a rate increase.

[62] As recently reported in the Wall Street Journal: "One in five U.S. households was behind on its utility bills coming out of last winter, a new survey concludes, raising fears that the current heating season could be even worse. One in 20 households had its utility service terminated in 2007." Rebecca Smith, *One in Five Households Fell Behind on Utility Bills Last Winter*, WALL STREET JOURNAL, December 17, 2008, at A6 (discussing a survey by the National Association of Regulatory Utility Commissioners).

Projected Savings from the Plan

VNG's customers who participate in the conservation measures proposed in the Plan can save money on the volumetric portion of their bills through reduced consumption. Quantifying total net savings for customers with accuracy is difficult, however. In this regard, we find VNG's claim that its customers, over a 10-year period, can save as much as $39.5 million from the Plan as proposed to be speculative.[63] While the *costs* to customers of the ECP will be definite, and price increases for non-gas service under the RNA Rider are probable, as explained above, attempting to quantify net *savings* from the Plan is an exercise dependent upon a myriad of changing factors, including the *future* behavior of customers and the *future* price of natural gas.

We note that on the date that VNG filed this Application (July 3, 2008), the price of natural gas at Henry Hub was $13.31 per MMBtu; by December 1, 2008, the price had plunged to $6.43,[64] a drop of *more than 50%* in just a few months. Whether prices will remain this low, go even lower, or skyrocket in the future is unknowable. In addition, while some of the recent drop in natural gas prices may be attributable to the worldwide decline in demand for all energy commodities because of the global economic crisis, there may also be reason to speculate that the natural gas markets in the United States are seeing the effects of substantial increases in domestic sources of supply, for example, from the Barnett field in Texas. There is also reportedly huge potential from the Marcellus Shale field in the Appalachian Basin.[65] The quantity of savings to customers on the volumetric portion of their bills from reduced consumption obviously moves in

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[63] *See* Exh. 2 (Gidley direct) at 6 ("For that level of expenditure [$7.5 million for the conservation programs, including the cost of capital], our customers can save up to $39.5 million over a 10-year period. *That is a permanent, sustainable savings that provides significant value to our customers*" (emphasis added).).

[64] *See, e.g.,* ICE Day Ahead Natural Gas Price Report published by ICE Data (https://www.theice.com/marketdata/reportcenter/reports.htm).

[65] This potential "super giant" gas field extends from far southwest Virginia through West Virginia, Ohio, Pennsylvania, and New York. *See, e.g.,* http://geology.com/articles/marcellus-shale.shtml.

concert with gas prices. There are, of course, other factors, such as finite pipeline capacity or the possibility of continued dollar devaluation in the future, that could put upward pressure on prices and increase savings from reduced consumption.

Accordingly, IT IS HEREBY ORDERED THAT:

(1) A three-year conservation ratemaking and efficiency plan, as permitted by § 56-600 *et seq*. of the Code of Virginia, is approved as set forth in this Order Approving Natural Gas Conservation and Ratemaking Efficiency Plan and shall become effective on January 1, 2009.

(2) The Revised Stipulation is approved as set forth herein.

(3) The ECP program costs shall be allocated as set forth herein.

(4) This matter is dismissed.

Commissioner Morrison participated in this matter.

Commissioner Dimitri did not participate in this matter.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to: Edward L. Flippen, Esquire, Kristian M. Dahl, Esquire, and Bernard L. McNamee, Esquire, McGuireWoods LLP, One James Center, 901 East Cary Street, Richmond, Virginia 23219-4030; C. Meade Browder, Jr., Senior Assistant Attorney General, Office of the Attorney General, Division of Consumer Counsel, 900 East Main Street, Second Floor, Richmond, Virginia 23219; and the Commission's Office of General Counsel and Divisions of Energy Regulation, Public Utility Accounting, and Economics and Finance.

A True Copy
Teste: Joel H. Peck
Clerk of the
State Corporation Commission